

THE COUNTY COMMISSIONERS OF CAROLINE COUNTY



CAROLINE COUNTY, MARYLAND

COMPREHENSIVE ANNUAL FINANCIAL REPORT

YEAR ENDED JUNE 30, 2012

**Prepared by:
Caroline County Office of Finance,
Caroline County Tax Office and
Ken Decker, County Administrator**

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INTRODUCTORY SECTION

COUNTY COMMISSIONERS *of* CAROLINE COUNTY, MARYLAND

LARRY C. PORTER
PRESIDENT

JEFFERSON L. GHRIST
MEMBER

WILBUR LEVENGOOD JR.
VICE PRESIDENT

SARA B. VISINTAINER
CHIEF OF STAFF

KEN DECKER
COUNTY ADMINISTRATOR

ERNEST A. CROFOOT
COUNTY ATTORNEY

October 24, 2012

LETTER OF TRANSMITTAL

TO THE
COUNTY COMMISSIONERS OF
CAROLINE COUNTY, MARYLAND,
AND COUNTY RESIDENTS

Introduction

The *Comprehensive Annual Financial Report of Caroline County, Maryland, for the Fiscal Year ended June 30, 2012*, is hereby submitted in accordance with state and local law. These laws require that Caroline County issue a report of its financial position and activity annually and that this report be audited by an independent firm of licensed certified public accountants selected by the County Commissioners. Management is responsible for both the accuracy of the data and the completeness and reliability of all of the information presented in this report.

To the best of our knowledge and belief, the enclosed data are accurate in all material respects, and are reported in a manner that presents fairly the financial position and results of operations of Caroline County Government and its component units. All disclosures necessary to enable the reader to gain an understanding of Caroline County's financial activities are included.

The management of local government entities is responsible for establishing and maintaining an internal control structure designed to ensure that government assets are adequately protected from loss, theft or misuse and to ensure that accurate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles (GAAP). The internal control structure is designed to provide reasonable, but not absolute, assurance that the financial statements will be free from material misstatement.

Caroline County Government's financial statements have been audited by TGM Group, LLC Independent Certified Public Accountants. The independent audit involved examining evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the audit, that there was a reasonable basis for rendering an *unqualified opinion that*

Courthouse
Telephone 410.479.0660

109 Market Street, Rm. 123
www.carolinemd.org

Denton, Maryland 21629
Facsimile 410.479.4060

the financial statements for Caroline County Government for the fiscal year ended June 30, 2012, are presented fairly and in conformity with GAAP. The auditor's report is presented as the first component of the financial section of this report.

The County is required to undergo an annual single audit in conformity with the provisions of the Single Audit Act of 1984 (as amended in 1996) and the provisions of the U. S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non Profit Organizations*. Information related to this single audit, including a schedule of expenditures of federal awards, the independent auditor's reports on internal controls and compliance with applicable laws and regulations, and a schedule of findings and questioned costs are included in a separately issued single audit report.

GAAP requires that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement MD&A and should be read in conjunction with it. The County's MD&A can be found immediately following the report of the independent auditors.

Caroline County Government Profile

Caroline County was created in 1774 by Maryland's last colonial governor from portions of Dorchester and Queen Anne's Counties. Caroline County has a Code Home Rule form of government, operating under Article 25B of the Annotated Code of Maryland. The County is governed by a three-member Board of County Commissioners, one of whom serves as President. All three County Commissioners are elected at-large and serve a four-year term. Both the executive and legislative functions of County government are vested in the County Commissioners. The County Commissioners may only exercise such powers as are conferred by the Maryland General Assembly, including authorization to issue debt to finance capital projects. The County Commissioners are empowered to levy a property tax on both the real and personal properties within its boundaries.

There are ten incorporated municipalities in Caroline County: Denton, Federalsburg, Goldsboro, Greensboro, Henderson, Hillsboro, Marydel, Preston, Ridgely, and Templeville. These incorporated municipalities are chartered local governments under Maryland law and are served by elected representatives. While Caroline County maintains positive relationships with the ten municipal governments, they are separate legal, corporate and financial entities.

Caroline County is located on Maryland's Eastern Shore, situated midway between Maryland's northern and southern borders, and the Chesapeake Bay and the Atlantic Ocean. It shares the historic Mason Dixon line with Delaware on its eastern border. It is bordered on the north by Queen Anne's County, on the west by Talbot County and on the south by Dorchester County. The County is 321 square miles in area and is approximately 10 miles wide at its midsection and 28 miles long. Denton is the County seat and principal town, with a population of 4,418 according to the 2010 Census. Denton is located 61 miles east from Baltimore, and 75 miles east of Washington, D.C. A major east-west roadway is Maryland Route 404, which connects with U.S. Route 50, U.S. Route 13, and is also served by U.S. Route 301. Caroline County is in the Atlantic Coastal Plain and its land area includes level terrain with streams and rivers flowing into the Chesapeake Bay.

The County is rural in character, with vegetable, grain and poultry farming as major industries. The County is part of a federally recognized "Ag Preservation Corridor" on the Delmarva

Peninsula, and land preservation efforts are well under way to preserve the land-based resources in this increasingly unique area. In an effort to increase economic stability and job availability, Caroline County has had some success in diversifying its economic base. Three industrial parks, predominantly occupied by manufacturing businesses, have resulted from that effort.

Caroline County serves a population of 33,072 (updated 2010 Census) with a full range of governmental services including public safety (police, corrections, emergency medical services, emergency management/911, and volunteer fire protection), construction and maintenance of roads, solid waste collection sites, health and social services, culture/recreation, public education, public improvements, planning and zoning and general administrative services. The County is also financially accountable for legally separate entities which are reported separately within the County's Financial Statement. The entities that meet these criteria are, Caroline County Board of Education and Caroline County Public Library. Additional information on these component units can be found in Note 1A.

County Budget Process

The annual budget serves as the foundation for Caroline County's financial planning and control. By March, the County Commissioners—acting as the County Board of Estimates—prepare revenue estimates for the coming fiscal year. All departments and agencies of the County are required to submit a budget allocation request to the Office of Finance by April of each year.

In practice, the budget process starts earlier. The Office of Finance provides routine reporting of revenues and expenditures throughout the fiscal year. This information provides ongoing feedback and direction on the adopted budget. From the beginning of the calendar year, the management team and key representatives from the allied agencies work collaboratively to prepare a sustainable, integrated operating and capital budget. The County Commissioners are directly involved in providing guidance with regard to policy objectives and priorities. The budget building process is open, transparent, iterative and team-oriented.

Two advertised public budget hearings are held. One public hearing is held in April to hear budget allocation requests, and a final public hearing is held in May on the proposed operating budget, capital program, and, as required by state law, on the proposed constant yield property tax rate.

The County Commissioners are required to adopt a budget and real property tax rate for the succeeding fiscal year by June 30 annually, the close of the County's fiscal year. A flow chart of the budget process and calendar is included within this report, as listed in the table of contents.

Factors Affecting Financial Condition

The information presented in the financial statements is perhaps best understood when it is viewed from the broader perspective of the economic environment within Caroline County.

Local Economy

Caroline County continues to endure the long-term downturn in the regional and national economies. While the County remains a highly desirable place to live and work, a moribund housing market, high unemployment and weak consumer demand are indicative of the ongoing economic slump.

Despite historic lows in mortgage interest rates, the housing market shows few signs of recovery. Building permit activity remains far below normal levels. The median sales price of a residential home has fallen from a peak of almost \$250,000 in 2007 to under \$120,000 in the second quarter of 2012.

The unemployment rate in Caroline County has dipped slightly from 8.9 percent last year to 8.6 percent this year. With the completion of a new store in Denton, Wal-Mart will become one of the largest local private employers.

The County's employment base includes agriculture, manufacturing, construction, transportation, government, and services sectors. About 60 percent of working residents commute to work locations outside the County, primarily to Talbot County (Easton) and the Annapolis/Baltimore/Washington area or into Delaware. Before the recession, the demand for housing in Caroline County was strong due to affordability and manageable commuting distances. This pressure for development has subsided with the downturn in the economy. Future growth hinges on the regional economy and factors such as fuel prices that influence commuting patterns.

Despite modest gains in the employment rate and the increased affordability of local housing, Caroline continues to rank among Maryland's poorest counties. Median household income was nearly \$59,000 according to the 2010 Census, considerably less than the Maryland median income of over \$70,000. The poverty rate in Caroline County is about 11.5 percent.

Long Term Financial Planning

The County Commissioners' six-year capital program is a tool for long-term financial planning to meet major needs. Pursuant to the County Code, the County Administrator presents the six-year capital projects plan to the County Commissioners annually in February. The County Commissioners hold public hearings regarding the capital program and adopt the first year as the capital budget for the coming fiscal year.

After the virtual elimination of Maryland State Highway User Revenues five years ago, the County greatly reduced capital spending as reflected in the approved budgets. The Caroline County Commissioners recognize the significant issue of deferred maintenance, particularly with regard to roads, bridges, vehicles and equipment. The Commissioners further recognize the need to address the condition of aging public buildings, including local schools, and that a sustainable capital improvement plan will require structural changes in the budget. In FY 12 the Commissioners used \$770,000 of capital reserve money for roads resurfacing and some other

high priority capital projects. The bulk of this funding resulted from a school renovation project coming in under budget and lower than anticipated maintenance expenses due to a mild winter.

Caroline County has an adopted policy to maintain a general (unassigned) fund balance of five percent of total budget expenditures. This fund balance is set aside for exigent circumstances like an emergency or natural disaster. The County has not had occasion to use these funds in the past fiscal year. In the event they are needed, the fund must be replenished within two years. As of June 30, 2012, unassigned fund balance exceeded 5% of 2012 general fund budgeted expenditures.

The most significant challenges to Maryland's local governments are the decisions by the Maryland State Legislature to shift costs and to impose new unfunded mandates. For example, during the 2012 General Session, the Legislature approved a measure shifting half the cost of teacher pensions to local governments. This will represent a new cost of \$1.2 million in FY 14 and will increase in subsequent years.

The Maryland Departments of Environment and Planning continued to press a large number of new environmental regulations. The Watershed Improvement Plan (WIP) for Caroline County has an estimated cost of \$168 million. This single unfunded mandate represents a potential cost of almost \$13,000 for every household in the County. The Legislature also passed laws limiting future residential development on private wells and septic systems. New requirements for fire suppression sprinkler systems in new homes and installation of "best available technology" (BAT) septic systems also will increase the cost of an average new home on well and septic by more than \$25,000.

One of the most important aspects of Caroline County's long-term financial planning is assessing the cumulative impacts of the new laws and regulations on development. The County lacks extensive public water and sewer systems. Regulations greatly increasing the cost of homes on private wells and septic systems are likely to hurt the local housing market as local residents find housing in nearby Delaware to be more affordable.

Over half of County residents already commute outside of the County to work. The limited availability of public water and sewer hamper potential economic development as does the County's lagging transportation infrastructure. The State of Maryland's failure to replace Dover Bridge and widen MD 404 makes Caroline County less attractive for new businesses. Even if there is a robust economic recovery in the region, it is likely Caroline County will lag behind due to the disproportionate impact of new regulations on rural, agricultural areas.

Local Fiscal Philosophy

In the midst of a very difficult economic and regulatory environment, the Caroline County Commissioners have established and maintained a philosophy of fiscal conservatism. While the Commissioners remain opposed to increases in existing taxes, they did impose the “constant yield” property tax rate for FY 13—an increase of two cents raising the County property tax rate to 89 cents per \$100 of assessed value. Because of a one-year “disparity grant” provided by the State of Maryland, the impact of teacher pensions on the County’s budget was relatively small during the first year of the transition. This state grant is unlikely to continue. Absent major cuts to the relatively small range of discretionary services provided by the County, the Commissioners will be forced to fund the \$1.2 million in FY 14 teacher pension responsibility with an increase in taxes.

While the County continued to operate on an austerity budget, the Commissioners moved ahead with changes designed to lower the County’s unfunded liability position. The Commissioners adopted policy changes to reduce the financial impact related to the end-of-career sale of unused sick leave.

The Commissioners remain strongly supportive of increased efficiency in service delivery. County government has continued to provide a high level of service despite reductions in funding and staff. During the past year, the Commissioners have reduced the size of County government. For the fourth consecutive year, there were no increases in pay granted to County employees. While the County made a substantial expenditure investment in some deferred maintenance line items, this one-time allocation fell short of the annual investment needed for true fiscal sustainability.

The Commissioners fully appreciate the gravity of the County’s financial situation and are strongly committed to fiscally responsible governance.

Awards and Acknowledgements

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to Caroline County, Maryland for its comprehensive annual financial report (CAFR) for each fiscal year since June 30, 2004. The Certificate of Achievement is a prestigious national award that recognizes conformance with the highest standards for preparation of state and local government financial reports. In order to be awarded a Certificate of Achievement, the County publishes an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards.

A Certificate of Achievement is valid for a period of one year only. Caroline County, Maryland received its eighth Certificate of Achievement last year. We believe our current comprehensive annual financial report continues to conform to the Certificate of Achievement program requirements and we are submitting it to GFOA to determine its eligibility for another certificate.

The preparation of the comprehensive annual financial report on a timely basis was made possible by the dedicated staff of the Caroline County Office of Finance, Caroline County Tax Office, and the Office of the County Commissioners. Special recognition is given to Margaret Roe and Catherine Moore for their effort in providing outstanding financial acumen, timely reporting and keen analysis. I am deeply appreciative for the fiscal prudence of the County’s allied agencies, including, but not limited to, the Caroline County Board of Education. The

County's department heads deserve recognition for maintaining positive staff morale and delivering results in the most challenging financial climate since the Great Depression of the 1930s. Finally, delivering this report is only possible through the continued leadership, courage and commitment of the Caroline County Commissioners.

Fortes fortuna adiuvat.

Respectfully submitted,

Ken Decker
Caroline County Administrator

The executive offices of Caroline County are located at the Caroline County Courthouse, 109 Market Street, Room 123, Denton, Maryland 21629. The County's central telephone number is 410.479.0660.

Certificate of Achievement for Excellence in Financial Reporting

Presented to

The County Commissioners
of Caroline County, Maryland

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2011

A Certificate of Achievement for Excellence in Financial
Reporting is presented by the Government Finance Officers
Association of the United States and Canada to
government units and public employee retirement
systems whose comprehensive annual financial
reports (CAFRs) achieve the highest
standards in government accounting
and financial reporting.



Linda C. Sandison

President

Jeffrey R. Emer

Executive Director

**Caroline County, Maryland
Governmental Organization
Certain Elected and Appointed Officials
As of June 30, 2012**

Certain Elected Officials

County Commissioners

Larry C. Porter, President
Wilbur Levengood, Jr., Vice President
Jefferson L. Ghrist, Member

Certain Appointed Officials

County Administrator
Finance Officer
Chief of Staff
County Attorney
County Comptroller
Director of Planning & Codes
Director of Public Works

Ken Decker
Margaret C. Roe
Sara Visintainer
Ernest A. Crofoot
Catherine P. Moore
Katheleen Freeman
George Jamar

Independent Auditor

TGM Group LLC
Certified Public Accountants
Salisbury, Maryland

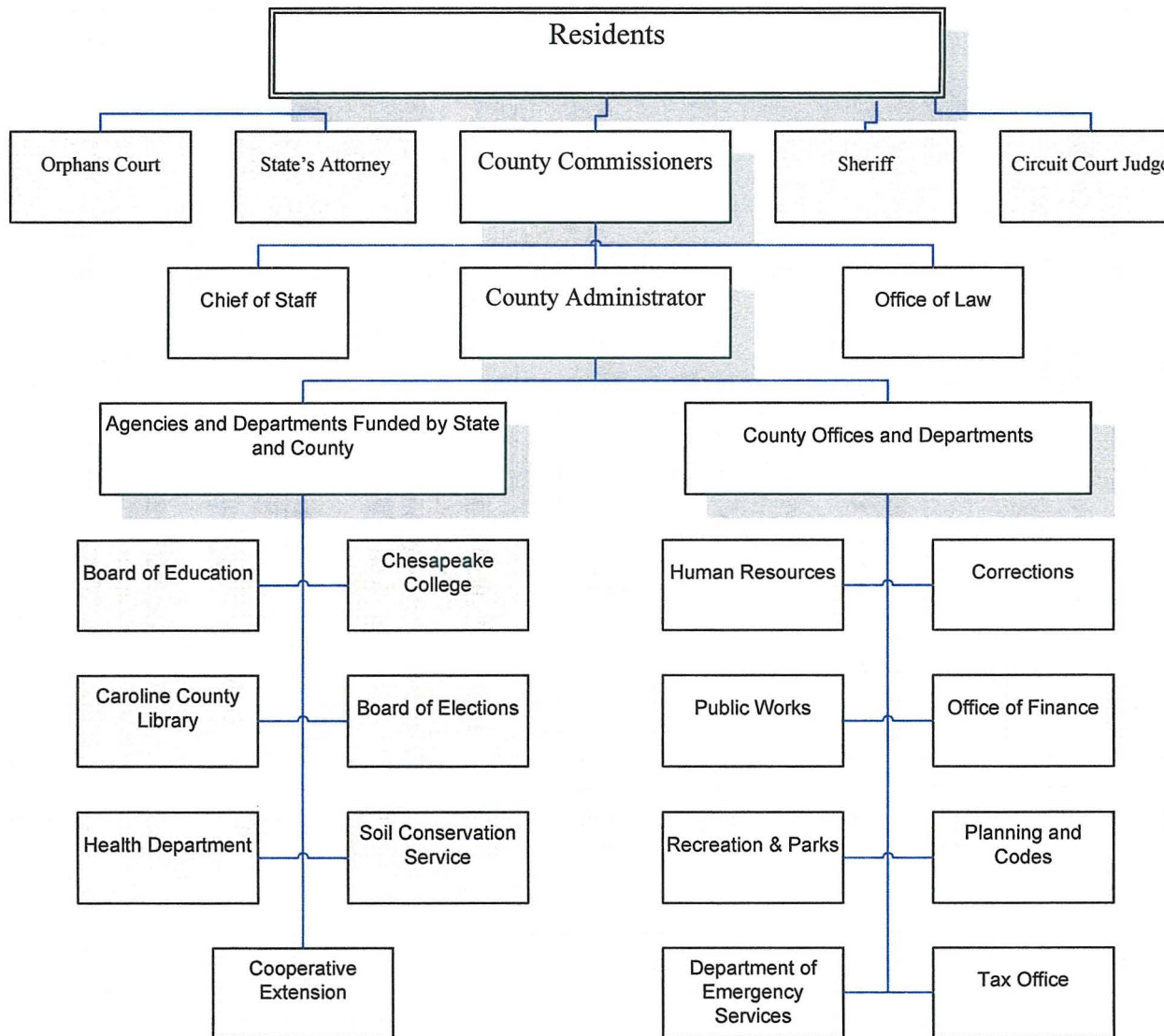
Bond Counsel

Funk and Bolton, P.A.
Baltimore, Maryland

Financial Advisor

Davenport & Company LLC
Towson, Maryland

CAROLINE COUNTY GOVERNMENT ORGANIZATIONAL CHART



Agencies and departments shown in gray boxes are not under the control or supervision of the county commissioners but are partially or wholly funded by county appropriation either under state law or at the discretion of the Commissioners.

FY 2012 BUDGET CALENDAR CAROLINE COUNTY, MARYLAND

Capital Improvement Budget

12/15/10

1/21/11

2/10/11

3/31/11

4/8/11

Start CIP
Process

Budget Submittal
Deadline for Depts
& Outside Agencies
to Comptroller

6 Yr. CIP Submitted
to Co Comms
(Statutory
Deadline 2/15/11)

Capital Roll-Over
Estimates Due From
Depts. & Agencies to
Comptroller

Comptroller
Submits Capital
Program to Finance
Director

General Fund Budget

6/30/11
Statutory Budget
Adoption Deadline

12/14/10

1/7/11

2/18/11

3/4/11

3/15/11

Tuesday

4/5/11

4/26/11

5/4/11

Thursday

5/19/11

5/24/11

6/7/11

Adopt
FY
2012
Budget
Calendar

Budget
Submittal
Requirements
Rec'd By
Depts. &
Agencies

All Dept. &
Agencies
Budget
Requests
Due
To Finance
Director
(Statutory
Deadline
4/1/11)

Commissioners
Given
Requests
Received
to Date

Comms
Receive
Baseline
Budget & Bd of
Estimates
Signs Sched of
All Revenue
Sources
(Statutory
Deadline
3/31/11)

Public
Hearing:
To Receive
Budget
Allocation
Requests
All Depts &
Agencies

Preston
VFC Hall
7:00 PM

Co Comms
Approve
Proposed
Budget &
Proposed
Prop Tax
Rate for
CY Ad

Advertise
Proposed
Budget
Summary &
Constant
Yield Ad
10 Days
Before
Public
Hearing

Public
Hearing:
Proposed
Budget,
Capital
Program
& Constant
Yield
Tax Rate

Setting
of Tax
Rate

Denton
VFC Hall
7:00 PM

Budget
Finalization
Workshop

Deadline
For appeals
From
Recipients &
Requestors

Budget
Adoption
Date

Budget Workshops
as Necessary